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Towards Financial Performance Measures and Benchmarks for the Canadian Tourism Sector

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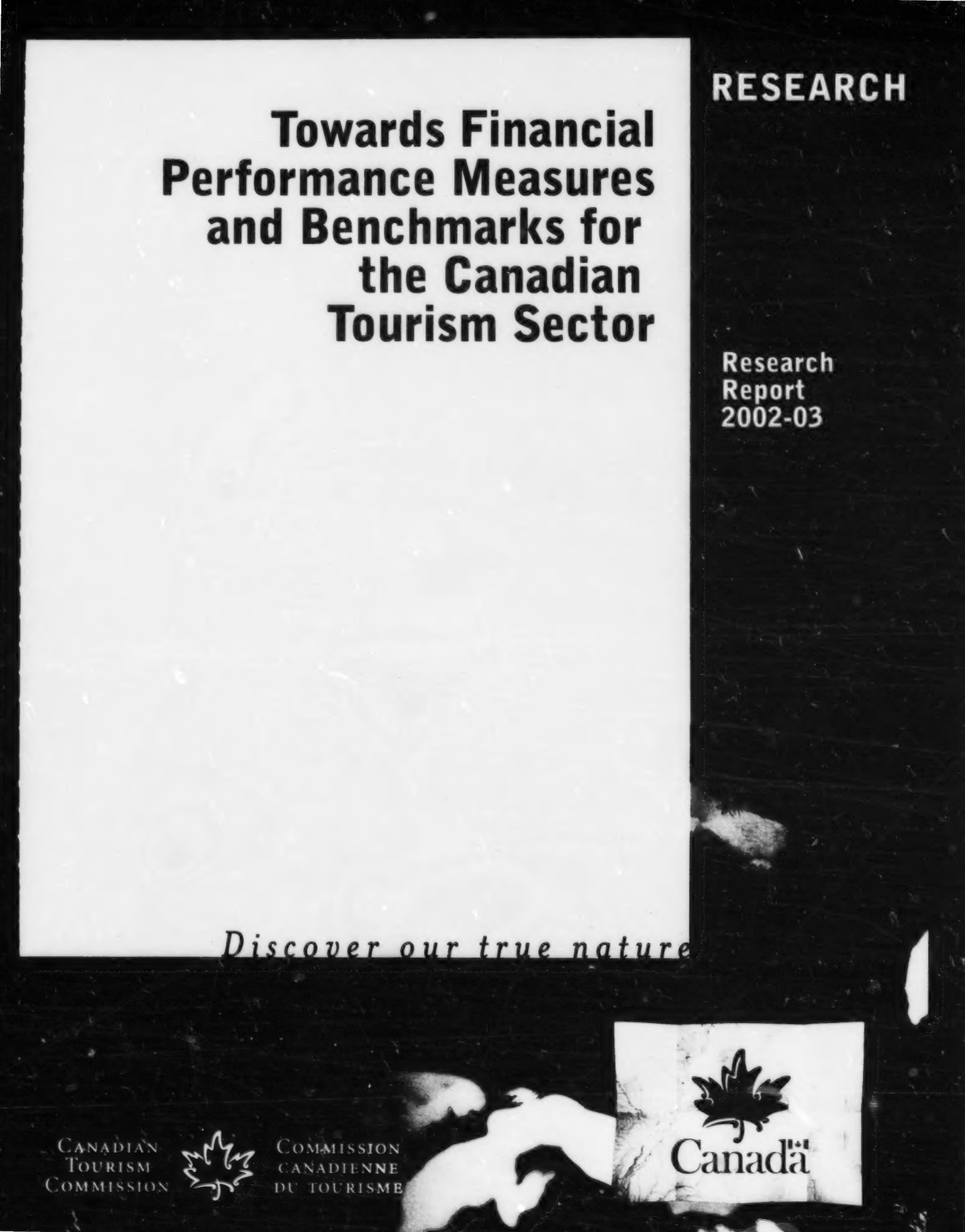

Canadian Tourism Commission

Commission canadienne du tourisme

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Towards Financial Performance Measures and Benchmarks for the Canadian Tourism Sector

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Abstract

This document explains how the Canadian Tourism Commission can help operators of business establishments calculate their performance measures and compare them to industry averages and benchmarks. In particular, this document explains the type of performance measures that can be calculated for various tourism industries (macro analysis) and by business establishments also operating in the tourism industry (micro analysis). Benchmarks, industry averages and performance measures used by the Canadian Tourism Commission and operators of business establishments are grouped under four categories: efficiency measures, liquidity measures, prosperity measures and stability measures. The documents used to calculate these measures are the income statements and the balance sheets produced by Statistics Canada.

The Canadian Tourism Commission can help operators of business establishments by providing them with a document called *Road Map to Tourism Financial Planning Guide*. This Guide will explain how, through the use of a financial planning spreadsheets, operators of small business establishments will be able to measure their operating and financial performance and compare them to industry averages and benchmarks. This service is made possible because of the strong link between: (1) the tourism satellite accounts (templates for the tourism industry), (2) the availability of an extensive business registry (inventory of businesses in Canada), (3) financial statistics (financial statements such as balance sheets and income statements), and (4) analytical tools and processes to be made available to operators of tourist business establishments (financial planning spreadsheets to calculate performance measures, benchmarks and industry averages).

Operators of tourist establishments will also find this *Guide* useful for preparing their business plans or investment proposals (objectives, strategies and operational plans) and for increasing their level of operational performance and managerial creativity.

Introduction

One important responsibility of operators managing business establishments is measuring their operating and financial performance. This analysis is done for two reasons. First, to evaluate the past in order to determine how well their business has done in terms of meeting their objectives and plans, and second, to formulate goals and strategies to help them improve their business establishment's operating and financial performance. This document explains how benchmarks and performance measures can be used as planning and analytical tools to gauge performance measures against industry averages and benchmarks.

The objectives of this document are twofold. First to give an overview of the presentation made at the Vancouver Conference Tourism Satellite Accounts (TSA): Credible Numbers for Sound Business Decisions hosted by the Canadian Tourism Commission on May 8-10, 2001, on how benchmarks and financial performance measures can be used as effective policy-making tools by the Canadian Tourism Commission and as planning instruments by operators of business establishments. Second, to explain the structure, contents and benefits of the *Road Map to Tourism Financial Planning Guide*, a document to be made available to business operators involved in the tourism industry to help them to calculate their performance measures and to compare them to industry averages and benchmarks.

Vancouver Presentation

On May 9, 2001, a presentation entitled Towards Financial Performance Measures and Benchmarks for the Canadian Tourism Sector was made in Vancouver at the Vancouver Hotel within the context of the Tourism Satellite Accounts (TSA): Credible Numbers for Good Business Decisions theme.

Before getting into the details of how benchmarks and performance measures can be used as planning, analytical and decision-making tools by operators of small business establishments, lets first define the meaning of the terms, *benchmarks* and *financial performance measures*.

Benchmarks

One popular management technique that has surfaced over the past decade is benchmarking. Essentially, *benchmarking* is the process of encouraging operators of business establishments to search for the best management and business practices in their industry. Comparing one's own performance measures to one or several competitors' excellent performance is referred to as a benchmark. Basically, a *benchmark* is an industry norm that management of a company can use to compare its own operating and financial performance. The purpose of benchmarking is to encourage business operators to seek solutions to problems or to improve performance simply by comparing one's performance to others who are considered the best in the industry.

Financial Performance Measures

The second theme of this document deals with financial performance measures. Performance measures help business operators evaluate their accomplishments with some degree of precision in terms of managing their cash, their debt, the productivity of their assets and most important, their bottom line or profitability. A *performance measure* is simply a comparison of one number (i.e., profit after taxes) to another (i.e., total assets) to express the size of one number in relation to the other (i.e., 10% return on assets). To many, performance measures are regarded as diagnostic tools. Just as a doctor measures various characteristics of the blood, evaluating a business establishment's accomplishments through performance measures can reveal symptoms of problems or of management errors that require correction.

Performance measures can make business analysis and decision-making useful and unambiguous. Also, they can be compared in a meaningful way to industry averages and benchmarks. The real value of performance measures when compared to benchmarks is that they give signals to operators of business establishment regarding what is good or bad about their own operations. By comparing one's performance measures to industry benchmarks encourages business operators to dig a little deeper in order to find answers to questions and to improve performance.

The Canadian Tourism Commission will make available through its website, industry averages and benchmarks for various tourism industry sectors and a financial planning spreadsheet that will help calculate quickly and accurately their historical performance measures and formulate their goals.

As will be covered later in this document under the heading *Financial Statement Analysis*, benchmarks and performance measures are be grouped under five categories:

1. Liquidity measures (cash management)
2. Debt/coverage measures (debt management)
3. Asset-management measures (productivity)
4. Profitability measures (efficiencies)
5. Growth and financial health measures (overall performance).

Benefits of Benchmarks and Financial Performance Measures

Both, the Canadian Tourism Commission and operators of business establishments can benefit by using benchmarks and performance measures.

Macro Level Analysis

The use of benchmarks and performance measures can help policy-makers at the Canadian Tourism Commission determine to what extent various tourism sectors are benefiting from policies formulated by various government departments or agencies, in particular the Canadian Tourism Commission. The use of performance measures to analyze different industries such as hotels and motor hotels, camping grounds and travel trailer parks and skiing facilities can help determine their financial health and vibrancy. For example, each industry can be examined as to how well it has performed in the past in terms of profitability, debt reduction, productivity and liquidity when compared to their respective benchmarks. Examples of this type of analysis will be covered under the heading *Financial Statement Analysis*. Also, the effects of the Canadian Tourism Commission objectives, policies and strategies related to each industry could be measured.

Micro Level Analysis

The use of benchmarks and performance measures as part of the planning process will also be helpful for business establishments. The use of performance measures (or ratios) to formulate objectives and plans is not a recent invention. However, the availability of the *Road Map to Tourism Financial Planning Guide* will be of great value to operators of small business establishments when preparing their business plans and investment proposals.

By going to the website, for example, www.canadatourism.com/tsa/roadmap, business operators of tourism establishments will be able to download the *Road Map to Tourism Financial Planning Guide* which will include:

- A *Guide* that explains the meaning of the various performance measures and how they are calculated;
- Financial planning spreadsheets;
- Benchmarks related to their own industry;
- Industry averages.

The objectives, structures and benefits of the *Guide* will be covered later in this document under the heading *Road Map To Tourism Financial Planning Guide*.

The *Guide* will be of great value to operators of small business establishments as a planning document for three reasons. First, it includes a brief explanation of the meaning of the various benchmarks and performances and how they are calculated. Second, there is a financial planning spreadsheet that will help business operators calculate their respective performance measures. It will only take a few moments (say between 20 to 30 minutes) to input a company's historical financial statements and what they expect to realize during the upcoming years. The financial planning spreadsheet compares a business establishment's performance measures to industry benchmarks and averages. Third, the *Guide* also includes three decision-making tools (break-even analysis, cash budgeting, capital budgeting) to help operators of tourism establishments in making their decisions.

Categories of Benchmarks and Financial Performance Measures

In the main, business performance is analyzed in terms of efficiencies, liquidity, prosperity, and stability. The *Road Map to Tourism Financial Planning Guide* will include benchmarks and industry averages for each of these categories to help operators of business establishments compare their respective performance. Here is a brief description and the importance of these various performance measures.

Efficiency Measures

Efficiency measures gauge the productivity of assets, that is, the relationship between profit and assets employed (i.e., return on assets, return on equity, and return on sales). The objective of these performance measures is to ensure that a company's assets are used efficiently and produce an adequate rate of return. A high level of profitability satisfies investors and indicates that business assets are working hard. To be sure, the more profit a business earns, the more cash it can re-invest in its operations to finance growth and to purchase capital assets. For example, if a company earns $0.08 (performance measure) on every dollar's worth of sales revenue (return on sales or ROS), this profit can be reinvested in the business in the form of retained earnings, say $0.05. With this money, the business can invest say $0.02 in working capital such as accounts receivable and inventory (for day-to-day operating purposes), and say $0.03 in capital assets to expand, purchase equipment and machinery (for long-term growth purposes). The rest of the money, that is $0.03 can be used for external purposes. Here, the shareholders can receive say $0.02 to compensate for the investment that they have made in the business, and say $0.01 to repay the principal on the debt. If the $0.08 return on sales begins to shrink, the company will have less internally generated funds to help finance its growth, to invest in capital assets, and to satisfy its shareholders.

Liquidity Measures

Liquidity measures gauge a company's ability to meet its short-term financial commitments. If a business increases its sales, it will inevitably increase its working capital accounts such as inventory, accounts receivable, cash required to pay its employees, its suppliers, and its creditors *on time*. As mentioned in the previous section under efficiency measures, an amount of $0.02 can be invested in working capital accounts. If a company wants to grow but shows a reduction in its return on sales performance, it will have less cash from internal operations to invest in working capital accounts, and may have to rely on short-term borrowings in order to keep growing. There is no question that too much borrowing reduces a company's profit (because of interest charges) and contributes to reducing return on sales. Gauging liquidity performance of a business is essential to determine whether a business can expand its business through internally generated funds.

Prosperity Measures

Prosperity measures gauges the growth of a business in terms of sales volume, sales revenue, profits, dividend payments, capital assets, shareholders' equity, and working capital. If a company's return on sales (efficiency measure) begins to deteriorate, management may not be able to finance its growth through *internally generated funds*. Consequently, the business would have difficulty investing in capital assets such as equipment and machinery in order to expand its operations and improve productivity. As mentioned under the heading efficiency

measures, an amount of $0.03 of internally generated funds can be invested towards the purchase of capital assets. Here, if a business wants to invest in these types of assets, it may have to borrow (if internally generated cash is not sufficient) from long-term lenders and shareholders to finance the purchase of these capital assets. Prosperity measures can help business operators determine the appropriate level of debt (and at what cost) that should be acquired in order to achieve the type of growth management wants to realize within its operations such as sales revenue, purchase of capital assets and investment in working capital. The sustainable growth rate performance measure (to be explained later) determines to what extent a business should grow in sales revenue without depleting its resources, excessive borrowing, or new share contribution by the owners.

Stability Measures

Stability measures gauge the financial structure of a business. It is important for any business to maintain equilibrium between the funds provided by lenders and those provided by shareholders (relationship between debt and shareholders' equity). If a business continues to borrow from lenders, it may have a high debt to equity ratio and as a result may not be able to meet its short- and long-term debt obligations, particularly if there is a slowdown in business activities caused by unfavourable economic conditions. If a company's return on sales is adequate, it will have enough cash to finance its growth. As indicated earlier under the heading efficiency measures, if an amount of $0.03 can be used for external activities to pay dividends to its shareholders ($0.02) and reduce the principal on its debt ($0.01). Here again, if a business does not produce an adequate return on sales, it may have to borrow more from lenders and, consequently, this would cause adverse effects on its stability. Stability measures help to determine (1) the appropriate level of debt and (2) whether a business has the ability to service its debt.

Financial Statements (Input Documents)

The input documents that are used to calculate performance measures for the various tourism industries are financial statements. Statistics Canada produces financial statements that is the balance sheet and the income statement on an industry basis. These financial statements can be used by the Canadian Tourism Commission to perform **macro-level** analysis.

At the ***micro level,*** *business operators* usually prepare for their lenders and/or investors *four* financial statements: the income statement, the statement of retained earnings, the balance sheet and the statement of cash flows. The following gives a brief description of these four financial statements. However, a more detailed explanation and examples of the statement of retained earnings and the statement of cash flows will be made under the heading *Road Map to Tourism Financial Planning Guide.*

The Income Statement

The *income statement* shows the flow of revenues and expenses incurred by a business during a given period (e.g., one month, that is from say June 1 to June 30, or for one year, say from January 1 to December 31). The income statement shows income or profit at four levels:

- The first level, *gross margin,* is the difference between the costs of producing the goods or providing services sold from sales revenue.
- The second level, *operating profit* or *operating income,* is the difference between operating expenses (i.e., selling and administrative expenses) and gross margin.
- The third level, *income before taxes*, is computed by adding other income (i.e., interest income) to the operating income, and by deducting from this balance, other charges such as interest and extraordinary expenses.
- The fourth level is *income after taxes*. It is often referred to as the "owners' section" since income after taxes belongs to the shareholders, to be paid in dividends or to be retained in the business for reinvestment purposes.

The Statement of Retained Earnings

The *statement of retained earnings* (which is not produced by Statistics Canada) is usually included in a company's Annual Report. This statement shows the amount of income retained in a business since it was started, identifies the income earned and the dividends paid during a current operating year and the amount of earnings remaining in the business at the end of the accounting period. This statement bridges the income statement and the balance sheet by showing how much money will be re-invested by the owners in the form of retained earnings.

The Balance Sheet

The *balance sheet* is divided into six sections. The upper portion shows what a business owns, or its assets. Asset accounts are grouped under three headings:

- *Current assets* are accounts that are liquid or can be converted into cash quickly (e.g., accounts receivable, inventory, marketable securities, and prepaid expenses).

- *Capital assets* (also referred to as fixed assets) include accounts such as land, buildings, machinery, and equipment, which are illiquid and used by the business over an extended period of time.
- *Intangible assets* include items such as goodwill and patents.

The lower portion of the balance sheet shows what a business owes to its creditors (lenders) and shareholders (owners). Debts are usually grouped under two headings:

- *Current liabilities* which are loans that come due within a 12-month period and include accounts such as accounts payable, term loans, and accrued expenses (or what a business owes to services it has received and not yet paid).
- *Long-term debts* such as long-term loans, bonds, and mortgages are loans that are to be paid beyond the current accounting period.

Equity

The lower portion of the balance sheet also shows the *equity* account, which are funds provided by the shareholders to a business.

The Statement of Cash Flows

The *statement of cash flows* is also contained in a company's Annual Report. This statement shows where funds came from and where they went between two accounting periods. This statement is divided into four sections:

- The first, *operating activities*, shows the sources and uses of funds generated by the business itself (i.e., income after taxes).
- The second, *financing activities*, includes items such as long-term loans and shareholders' participation.
- The third, *investing activities*, includes transactions such as the purchase or sale of assets.
- The fourth, *cash balance*, shows the effects that all changes (sources or uses of funds) recorded under the three above mentioned activities have had on the cash account.

Financial Statement Analysis

This section presents the type of analysis that can be done for evaluating the performance of an industry (at the macro level) and at the business establishment level (micro level). Benchmarks can be used at both the macro level to determine the historical overall health of an industry and at the micro level to gauge how well a business establishment is doing in terms of productivity, profitability, growth and financial health.

Both performance measures and benchmarks can be used as indicators to raise questions regarding productivity, debt structure, profitability and liquidity. Here are typical questions:

- Is the industry/business establishment able to meet its current debt obligations?
- Are the industry/business establishment's assets being managed effectively?
- Are the industry/business establishment's accounts receivable and inventory at suitable levels?
- Will the industry/business establishment be able to meet its long-term debt commitments?
- Can the industry/business establishment service its debt?
- Is the industry/business establishment profitable?
- Is the industry/business establishment using its assets or resources efficiently?
- How does the business establishment's financial structure and profitability compare with those of others in the same industry and also to the benchmarks?
- Is the industry/business establishment's shareholders' return on investment satisfactory?
- Do investors have a high regard for the industry/business establishment?

The benchmarks and performance measures are grouped under the following five categories:

1. Liquidity measures
2. Debt/coverage measures
3. Asset-management measures (productivity)
4. Profitability measures (efficiencies)
5. Growth and financial health measures

The following pages:

1. Explain the meaning of each category of benchmarks or performance measures.
2. Give examples of the types of questions or issues that can be raised under each category of benchmarks and performance measures.
3. List the performance measures and benchmarks that are included under each category.
4. Provide examples of performance measures that can be calculated for different tourism industries. The comments (this should not be considered an analysis) made related the

various industries can only be brief and superficial for two reasons. First, the reasons for showing good or bad performance for an industry during a particular year are not known. Second, to do a comprehensive analysis of an industry or a business establishment, it is also important to examine a business from different angles (liquidity, profitability, asset-management, debt/coverage).

Liquidity Measures

Liquidity performance measures gauge the extent to which a business has enough cash (liquidity) to pay its day-to-day operating expenses and retire other liabilities on schedule. These measures help to judge the adequacy of liquid assets for meeting short-term obligations as they come due.

Liquidity performance measures can help find solutions to the following questions:

- What should be the most favorable mix between an industry/business establishment's current assets and current liabilities?
- Does the industry/business establishment have too much accounts receivable and inventory on hand?
- What should the industry/business establishment do to improve its cash conversion cycle?

Types of liquidity performance measures

The seven performance measures commonly used to gauge liquidity are:

1. Working capital ($)
2. Current ratio (times)
3. Cash ratio (times)
4. Quick ratio (times)
5. Working capital turnover (times)
6. Days of working capital (days)
7. Cash conversion efficiency ratio (%)

Examples of liquidity performance measures for three industries

Examples of current ratios for the air transport industry, other amusement services and restaurants, licensed business establishments with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Air Transport Industry 4511 / 100-141	0.97	0.80	0.88	0.83
Other Amusement Services 8229 / N/A	0.76	0.68	0.92	N/A
Restaurants, Licensed 9211 / 9,246-13,516	0.76	0.65	0.64	0.92

Benchmark: While manufacturing firms should operate at a 1.5 ratio, service industries like the ones found in tourism establishments should operate at a 1.0 ratio.

Comments: As shown, all three industries are operating slightly below the benchmark. It means that for every dollar's worth of current liabilities, business establishments in these industries have less than a dollar's worth of current assets. Therefore, business establishments in these sectors could have difficulty in meeting short-term financial commitments if there is an economic slowdown in their respective sectors.

Debt/coverage Measures

Debt-coverage performance measures determine to what extent a business or industry is over or under extended in debt. These measures help to determine whether a business has (or will have) the ability to pay its principal and interest obligation as they come due. Cash flow performance and capital structure (proportion of debt to equity) can help determine the solvency (ability to pay its debts) prospects of an industry or business establishment in order to avoid financial trouble.

Debt/coverage performance measures can help find solutions to the following questions:

- Does the industry/business establishment have too much debt compared to what owners have invested in the business (equity)?
- Does the industry/business establishment have the ability to service its debt?

The first question measures debt proportion (to equity) while the second measures coverage or ability to service debt.

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Types of debt-coverage performance measures for three industries

The four debt-coverage performance measures commonly used to gauge debt-coverage are:

1. Debt-to-total assets ratio (%)
2. Debt-to-equity ratio (times)
3. Times-interest-earned ratio (times)
4. Fixed-charge-coverage ratio (times)

Examples of debt-to-total assets performance measures for three industries

Examples of debt-to-total assets performance measures for the taxicab industry, ticket & travel agencies and restaurants, licensed business establishments with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Taxicab Industry 4581 / 998-1,0333	68.5%	68.4%	68.4%	67.5%
Ticket & Travel Agencies 9961 / 3,231-3,482	74.7%	71.1%	71.7%	69.7%
Restaurants, Licensed 9251 / 9,246-13,516	89.5%	88.6%	91.5%	88.4%

Benchmark: Benchmarks for debt-to-total assets vary from industry to industry and even the type, nature and location of the assets that lenders take into consideration for collateral purposes. The type of assets determines in large measure how much a lender will lend to a business establishment. However, businesses that are listed on stock exchanges have (in general) a 50 per cent debt-to-total asset ratio. As far as small and medium sized privately owned business establishment, the ratio could range from 30 per cent to as high as 90 per cent. Lenders could provide valuable information regarding benchmarks for different industries.

Comments: As shown, all three industries show a high debt ratio during the four-year period. This means that most lenders are taking significant risks unless of course owners guarantee the loans on a personal basis.

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Examples of times-interest-earned performance measures for three industries

Examples of times-interest-earned performance measures for the air transport industry, taxicab industry, and hotel and motor hotel business establishments with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Air Transport Industry 4511 / 100-141	1.8	1.9	2.0	0.7
Taxicab Industry 4581 / 998-1,033	2.5	3.3	1.1	3.0
Hotels and Motor Hotels 9111 / 2,635-3,200	1.6	1.7	2.2	2.0

Benchmark: The times-interest-earned performance measure shows the extent to which a business is able to service its debt. A 4.0 ratio is considered acceptable for any type of industry or business. This means that for every $4.00 worth of income before taxes and interest, $1.00 goes for the payment of interest, which leaves $3.00 to pay the principal on the debt, the income taxes and the dividends and a reasonable amount of money to be re-invested in the business in the form of retained earnings. The higher the ratio, the easier it is for a business to service its debt.

Comments: As shown, all three industries are operating at way below benchmark and suggest that business establishments operating in these industries are heavily indebted (as evidenced by the debt-to-total assets performance measures) and could have difficulty obtaining additional financing for expansion purposes. The only two ways for the industry or a business establishment to improve this performance measure are by reducing its debt or by improving the income before taxes and interest.

Asset-Management Measures

Asset-management performance measures can help operators of business establishments evaluate the level of productivity of their assets. These performance measures gauge the efficiencies with which a business establishment uses its assets or resources (i.e., inventories, accounts receivable, capital assets) in order to generate a profit.

Asset-management performance measures can help find solutions to the following questions:

- Is the amount of money invested in each category of asset in various *working capital accounts* shown on the balance sheet too high or too low in view of what the industry/business establishment has accomplished or wants to accomplish in the future?
- Is the amount of money invested in each category of *capital assets* shown on the balance sheet too high or too low in view of what the industry/business establishment has accomplished or wants to accomplish in the future?

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* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Types of asset-management performance measures

The six asset-management performance measures commonly used to gauge the productivity of assets are:

1. Average collection period (days)
2. Accounts receivable turnover (times)
3. Inventory turnover (times)
4. Day's sales to inventory (days)
5. Capital assets turnover (times)
6. Total assets turnover (times)

Examples of the average collection period for three industries

Examples of the average collection period performance measure for travel agencies, air transport and other entertainment and related services businesses with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Travel Agencies 9961 / 3,231-3,482	47.3	50.5	46.1	N/A
Air Transport Industry 4511 / 100-141	50.1	36.6	36.5	45.2
Other Entertainment & Related Services 8219 / N/A	76.8	87.9	48.5	N/A

Benchmark: The average collection performance measure simply shows how long a business establishment's average sales dollars remain in the hands of its customers. A longer collection period automatically creates a larger investment in assets and may even indicate that the business is extending credit terms that are too generous. Although the average collection period varies from industry to industry, in the main, a 30-day average collection period is considered satisfactory. In many service industries, however, this performance measure is not relevant because most businesses sell their services to customers on a credit basis (i.e., Visa, MasterCard). The only significant outstanding accounts receivable would be sales made to industrial accounts.

Comments: As shown, all three industries are operating at above the benchmark and have more money invested in working capital accounts than is required.

Examples of total-assets-turnover performance measures for three industries

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Examples of the total-assets-turnover performance measure for the gambling operations, golf courses and hotels and motor hotel business establishment with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Gambling Operations 9661 / 319-537	1.86	1.43	1.32	1.46
Golf Courses 9651 / 1,048-1,303	0.47	0.47	0.48	0.48
Hotels and Motor Hotels 9111 / 2,635-3,200	0.62	0.64	0.62	0.57

Benchmark: The total-asset-turnover performance measure gauges the turnover or utilization of all of a business establishment's assets, both capital assets and current assets. It gives an indication of the efficiency with which assets are used; a low ratio means that excessive assets are employed to generate sales and/or that some assets (capital or current) should be liquidated or reduced. Benchmarks for total-assets-turnover performance measure vary from industry to industry. Lenders could provide valuable information regarding benchmarks for different tourism sectors.

Comments: As shown, the only industry that generates more sales revenue than the total assets invested in the business establishments is gambling operations. The other two industries show a low productivity ratio.

Profitability Measures

Profitability performance measures help operators of business establishments to compare their bottom-line performance (profit) relative to sales, investment in assets, and equity. These performance measures show the level of business efficiency and effectiveness and reflect the results of a large number of policies and strategic decisions. They also show the combined effects of operating results of liquidity, asset management, and debt management.

Profitability performance measures can help find solutions to the following questions:

- Is the industry/business establishment squeezing enough profit from each sales dollar?
- Is the industry/business establishment generating a greater return on assets when compared to the cost of capital?
- Is the industry/business establishment generating a sufficient return made by investors to compensate for the risk?

Types of profitability measures

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

The six profitability performance measures commonly used to gauge overall business efficiencies are:

1. Gross margin on sales (%)
2. Operating income to sales (%)
3. Income after taxes to sales (%)
4. Return on total assets (%)
5. Return on invested capital (%)
6. Return on equity (%)

Examples of income after taxes to sales revenue performance measure for three industries

Examples of the income after taxes to sales revenue performance measure for the hotel & motor hotels, ticket and travel agencies, and restaurants, licensed business establishments with sales over $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Hotel & Motor Hotels 9111 / 66-102	-0.6%	4.8%	4.6%	10.7%
Ticket and Travel Agencies 9661 / 52-62	1.2%	0.9%	0.0%	0.4%
Restaurants, Licensed 9251 / 33-44	0.4%	1.6%	0.5%	6.4%

Benchmark: The profit (or income) after taxes to sales revenue (or return on sales) performance measure gauges a business establishment's overall ability to squeeze profits from each sales dollar. This is an important performance measure since profit-seeking business establishments are keenly interested in maximizing their return on sales since this bottom-line figure represents funds either distributed to shareholders in the form of dividends or retained and reinvested in the business establishment in the form of retained earnings. To be sure, the higher the performance measure, the more beneficial it is to the wealth of the business establishment and to its shareholders. Benchmarks for the profit after taxes to sales revenue performance measure vary from industry to industry. Lenders could provide valuable information regarding benchmarks for different industries.

Comments: As shown, all three industries show much different return on sales performance with the hotel and motor hotels going from a negative 0.6 per cent in 1995 to a positive 10.7 per cent in 1998. This means that in 1998, the hotel and motor hotels business establishments were able to generate 10.7 cents for every dollar's worth of sales revenue. This provided them with sufficient cash (compared to previous years) to reinvest and to pay dividends to shareholders. The only way to show a substantial change in this performance

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

measure (from a negative to a positive) is to have sales revenue increasing at a higher rate than the expenses incurred to operate the business establishment, or by going through (if sales are not increasing substantially) a cost reduction program (i.e. downsizing, reengineering). With regard to the ticket and travel agencies, profits (compared to sales revenue) deteriorated between 1995 and 1997 with a slight gain in 1998. The restaurants, licensed business establishments have generated a strong profit performance in 1998 that could have been caused by a much higher increase in sales revenue than the costs themselves.

Examples of return on total assets performance measure for three industries

Examples of the return on total assets performance measure for the air transport industry, other recreational and vacation camps and entertainment production companies and artist business establishment with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Air Transport Industry 4511 / 100-141	3.4%	-4,7%	-6.2%	0.5%
Other Recreational & Vacation Camps 9631 / 326-362	1.1%	-0.6%	-0.1%	-0.3%
Entertainment Production Companies & Artists 9631 / 1,703-1,931	6.4%	4.1%	4.2%	3.5%

Benchmark: The return on total assets performance measure gauges the profit performance in relation to assets committed by business establishments and is viewed as a measure of efficiency of total asset usage. Benchmarks for the return on total assets performance measure vary from industry to industry. Lenders could provide valuable information regarding benchmarks for different industries. However, it is widely believed that a business establishment should at least generate a higher return on total assets than the cost of borrowing funds to finance these same assets.

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Comments: As shown, all three industries have shown a wide-range performance measures from the negative to the positive. The only way that a business establishment can improve this performance measure is by (1) increasing its profit position, (2) reducing the size of its assets by liquidating some or (3) by a combination of both.

Examples of return on equity performance measure of three industries

Examples of the return on equity performance measure for the gambling operations, golf courses and hotels and motor hotel business establishments with sales under $10 million for the years 1995 to 1998 are as follows:

	1995	1996	1997	1998
(SICC / # of establishments*)				
Gambling Operations 9661 / 319-537	22.9%	14.5%	16.9%	26.6%
Golf Courses 9651 / 1,048-1,303	0.4%	-0.9%	0.7%	3.3%
Hotels & Motor Hotels 9111 / 2,635-3,200	2.3%	2.0%	12.2%	2.9%

Benchmark: The return on equity performance measure relates the income after taxes to owners' equity and is critical to shareholders since it shows the yield they earn on their investments. It also allows shareholders to judge whether the return on their investment is worth the risk. Benchmarks for the return on equity performance measure vary from industry to industry. Lenders could provide valuable information regarding benchmarks for different industries. However, it is widely accepted that a business establishment should at least generate a return on equity that satisfies its shareholders over an extended period of years, otherwise, they would simply sell their shares and invest their funds in more lucrative business establishments.

Comments: As shown, all three industries are showing varying performances from year to year with positive results in 1998.

Growth and Financial Health Performance Measures

In addition to the traditional performance measures used by operators of business establishments to gauge their performance, three more sophisticated financial tools namely, the economic value added, the sustainable growth rate and the financial health score can help measure the effectiveness of an industry or a business establishment; they are the economic value added, the sustainable growth rate and the financial health score.

* The number shown under # of establishments indicates the number of establishments that were included in the tabulation between the years 1995 and 1998.

Economic value added. A new performance measure that has gained prominence in the business community over the past several years is the economic value added (EVA). This performance measurement tool gauges the after-tax operating profit to cost of capital. Basically this performance measure gauges the *wealth* a business has created for its investors.

The EVA performance measure can help operators of business establishments find solutions to the following questions:

- Is the cost of capital too much compared to the return that is being generated by the industry/business establishment?
- What should be done to add more value to the wealth of the shareholders?

Benchmark: Although there are no industry benchmarks for EVA, this measurement tool tells business operators the level of wealth in terms of dollars that a business establishment generates for its owners. For example, if the cost of capital for a business establishment is 10 per cent and the after-tax operating profit is 13 per cent, the 3 per cent spread which can be used to determine the additional ownership wealth (commonly referred to as EVA) would be considered favourable. If EVA shows a negative result, it would be considered unfavourable.

Sustainable growth rate. This performance measure gauges the maximum rate at which a business establishment's sales revenue can increase without depleting its operating and financial resources. Essentially, this tool measures a business establishment's *optimum growth rate* by relating net income to sales revenue, reinvested income to income before dividends, total liabilities to net worth and assets to sales.

The sustainable growth rate performance measure can help find solutions to the following questions:

- Is the industry/business establishment growing too fast for the amount of resources that it has?
- What should the industry/business establishment do if it wants to exceed its sustainable growth?
- How will the industry/business establishment be able to manage its growth?

Benchmark: There are no industry benchmarks for the sustainable growth rate performance measurement tool. Each industry or business establishment determines its own growth rate depending on the level of resources that it has. For example, if an industry or a business establishment's sustainable growth rate during the coming year indicates 10 per cent and the industry or business expects to grow by 20 per cent, this performance measurement gives a signal to operators of business establishments that additional resources will be required to meet the anticipated growth rate.

Financial health score. This performance measure uses a combination of traditional financial ratios and a sophisticated statistical technique known as discriminant analysis to construct a financial model for assessing the likelihood that a firm will go bankrupt. This model combines five financial measures utilizing accounting variables to arrive at an objective overall measure of corporate health called the *Z-score*.

This financial health score can help businesses and the industry find solutions to the following questions:

- Is there a good or bad relationship between earnings before interest and taxes to total assets?
- Is there a good or bad relationship between total assets to net working capital?
- Is there a good or bad relationship between total assets and retained earnings?
- Is there a good or bad relationship between debt to equity?
- Is there a good or bad relationship between sales to total assets?

Benchmark: The only important number for an industry or business establishment is that a score should be higher than 3.0. This score is considered acceptable for any type of business. If it is less than 3.0, the industry or business establishment should find a solution to correct unfavourable operating conditions. The benchmark is this: if a business has a 3.0 or higher score, it indicates good financial health. If the score is less than 1.8, it indicates that the business would be in danger of bankruptcy.

An Example of an Output Document

The following gives a summarized version of the layout of one output document for liquidity performance measures that could be produced by the financial planning spreadsheet at the industry level (macro analysis) and the business establishment level (micro level analysis). The output document for the performance measures covered in this document falls under the four categories: liquidity measures, debt/coverage measures, asset-management measures and profitability measures.

	Actual 2000	Forecast 2001	Objective 2002	Industry Average	Benchmark
Liquidity Performance measures					
Working capital ($000)	127	267	564	387	N/A
Current ratio (X)	1.14	1.26	1.55	1.32	1.70
Cash ratio (X)	0.12	0.13	0.14	0.10	0.14
Quick ratio (X)	0.61	0.68	0.87	0.72	1.00
Working capital turnover (X)	175.9	93.9	49.6	54.3	50.0
Days of working capital	6.2	8.0	11.1	9.0	15.0
Cash conversion ratio based on operating cash flow (%)	N/A	18.7	20.2	17.5	N/A
Cash conversion ratio based on profit plus depreciation (%)	18.2	19.2	21.2	20.0	12.4

Road Map to Tourism Financial Planning Guide

One of the major problems that would face operators of small business establishments when calculating and analyzing their performance measures is the knowledge that they would require to understand the basics of financial management and the amount of time it would take to calculate all types of performance measures described in this document, from the most simple ones like the liquidity ratio to the most complicated like the financial Z-score or the sustainable growth rate.

The *Roadmap to Tourism Financial Planning Guide* is designed to solve these two problems. It will be written for operators of small business establishments with little or no financial expertise. The main objective of this *Guide* will be to help them analyze their financial statements, understand the meaning of performance measures and how they can be compared to industry averages and benchmarks.

The *Guide* will help them appreciate the importance of the various performance measures covered in this document, how they are calculated, and more importantly, how they can be used as analytical and decision-making tools.

Objectives of the Guide

The objectives of the *Road Map to Tourism Financial Planning Guide* are to provide operators of small business establishments with a *practical* and *effective* tool to help them:

- Understand the fundamentals of financial management.
- Read the scoreboard of business – financial statements;
- Use performance measures and compare them to their own industry benchmarks.
- Integrate performance measures into their business thinking process.
- Take the "gut feel" out of decisions and learn how to use performance measures in a meaningful way.
- Formulate effective business game plans by using performance measures and benchmarks.
- Formulate business decisions within a strategic planning framework.

Contents of the *Road Map to Tourism Financial Planning Guide*

The *Road Map to Tourism Financial Planning Guide* will be in two parts.

The first section of **Part One** of the *Guide* explains the fundamentals of financial management and how a business establishment's performance measures are calculated and can be compared to industry averages and benchmarks. This section of the *Guide* also explains the structure and contents of the key financial statements.

The *Guide* will also give examples about how financial statements can be interpreted and used to compare one's performance measures to industry averages and benchmarks. Specifically, it will explain the more important performance measures (e.g. liquidity, debt-coverage, asset-management and profitability) including the sustainable growth rate and the financial health score. More importantly, it will show how these performance measures can be used as management tools to improve business performance when compared to benchmarks.

The second section of **Part One** explains how three financial planning tools, namely, break-even analysis, cash budgeting and capital budgeting can be used to help business operators improve efficiencies, effectiveness and productivity.

Part Two of the guide will show how financial planning spreadsheets can be used as effective tools for analyzing and making business decisions. The four key objectives of these spreadsheets are to help:

- Remove the chore of spending endless hours on "crunching" numbers and more on analyzing operational and financial performance when comparing to industry averages and benchmarks.
- Analyze financial statements quickly, accurately and effectively.
- Gauge the impact of various business strategies and plans on a company's operational and financial performance.
- Assess performance measures by using state-of-the art decision-making tools.

Financial Planning Spreadsheets

The objective of financial spreadsheets is to help operators of business establishments to quickly and effectively calculate all performance measures covered in *Road Map to Tourism Financial Planning Guide.* The financial planning spreadsheets can calculate the most simple performance measures such as the return on sales to the most complicated ones such as the sustainable growth rate, the financial health score and the internal rate of return.

This section will explain how the financial planning spreadsheets can be used. The spreadsheets dealing with financial statement analysis contains two types of documents: input documents and output documents.

Input Documents

The spreadsheets include three input documents. The operator of a business establishment would input the numbers of his/her financial statements on the following three input documents:

Income Statement

Statement of Retained Earnings

Balance Sheet

Output Documents

The output documents contain eleven pages of information. These pages show the various performance measures that can be calculated by using the information on input documents. These eleven pages help operators of business establishments to analyze their financial statements and to make decisions. The following gives a list of the output documents.

Statement of Sources and Uses of Funds

Statement of Cash Flows

Vertical Analysis of the Income Statement

Horizontal Analysis of the Income Statement

Vertical Analysis of the Balance Sheet

Horizontal Analysis of the Balance Sheet

Performance Measures

Cash Flow

Economic Value Added

Sustainable Growth Rate

Financial Health Zone

Decision-Making Tools

Three financial analysis and decision-making spreadsheets are also be included in the *Road Map to Tourism Financial Planning Guide*. They are the break-even analysis, the cash budget, and capital investment decisions tools.

Break-Even Analysis

Monthly Cash Budget

Capital Project Analysis

Break-Even Analysis

Break-even even analysis is a straightforward yet very powerful financial tool that can help operators of small business establishments make a wide range of important operating decisions that touch on all aspects of business activities. Here are a few examples:

- For pricing decisions, break-even analysis helps to analyze the effect of changing prices and volume relationships on profit levels.
- For launching a new product, a new service, hiring a new employee, opening a new office, or spending additional funds on an advertising or promotional campaign are typical decisions that break-even analysis can help determine the extent to which additional sales revenue will be sufficient to justify the added costs.
- For automation or modernization decisions, break-even analysis can help disclose profit implications.
- For profit decisions this technique pinpoints what a business needs to achieve in sales revenue in order to realize a certain level of profitability.

To make break-even decisions, operators of business establishments have to identify which costs are fixed and which are variable. Once done, the break-even analysis can be used very effectively to make critical operating decisions.

Monthly Cash Budget

Monthly cash budgets are used for cash planning and control. They are also used for negotiating a line of credit with commercial banks. These budgets trace, on a monthly basis, the funds that will be (1) available and (2) required. In short, cash budgets keep track of the adequate monthly cash balances that your business needs, avoiding unnecessary idle cash and possible cash shortages. The cash budget is usually broken down in four sections:

- The cash receipts section.

- The cash disbursement section.
- The cash surplus or deficit section.
- The financing section.

The cash budget is an effective financial that allows for deliberate planning for the efficient acquisition of funds and for short-term investments.

Capital Project Analysis

Capital project analysis and decision-making tools that can help operators of business establishments determine whether to proceed or not to proceed with important capital investment decisions are time value of money yardsticks. A capital investment may be defined as a project that requires extensive financial resources (outflows) in return for expected flow of financial benefits (inflows) to be earned over a period of years.

There are many investment appraisal techniques that can be used to justify the justification of a capital project. The three more important yardsticks that will be included in the *Guide* are time value of money techniques, namely the payback period, the net present value and the internal rate of return.

- The *payback method* measures the period of time (years) it takes for the cash outflow of a project (investment) to be totally recovered by the anticipated cash inflows; in other words, it measures how soon the initial funds disbursed are recovered by a project. This investment yardsticks measures "time risk" and not "risk conditions."
- The *net present value technique* (NPV) measures the difference between the sum of all cash inflows and the cash outflows discounted at a predetermined interest rate that sometimes reflects the company's cost of capital. This method helps to establish whether or not the use of borrowed funds for a specific undertaking has greater financial merits than the cost itself.
- The *internal rate of return* (IRR) uses the specific interest rate used to discount all future cash inflows, so that their present value equals the initial cash outflows. This technique simply shows the economic merits of several projects and compares their returns to other financial indicators, such as the weighted cost of capital and the company's aggregate rate of return.

Conclusion

Within the Canadian System of Tourism Statistics, the Canadian Tourism Commission can add value to the services that is now available to tourism establishments because of the strong links among the following four elements:

- The tourism satellite account that provides templates for the tourism industry.
- The extensive business registry that includes a comprehensive inventory of businesses in Canada.
- Financial statistics that include critical data such as the balance sheet and the income statement.
- Analytical tools and processes that can help individuals calculate performance measures at the both, the industry level (macro) and at the business establishment level (micro). These tools would be included in the *Road Map to Tourism Financial Planning Guide.*